

JSC PRODUCERS

IBLA 85-418

Decided October 2, 1987

Appeal from a decision of the Wyoming State Office, Bureau of Land Management, declaring an oil and gas lease to have expired under its own terms. W-42623-A.

Set aside and remanded.

1. Oil and Gas Leases: Assignments or Transfers -- Oil and Gas Leases: Expiration -- Oil and Gas Leases: Extensions

An oil and gas lease created by a partial assignment during the primary term of the original lease is entitled to a 2-year continuation dating from discovery of oil or gas in paying quantities on any other segregated portion of the original lease, regardless of whether the discovery occurred prior to or after the effective date of the assignment.

APPEARANCES: George F. Martens, Esq., Denver, Colorado, for appellant.

OPINION BY CHIEF ADMINISTRATIVE JUDGE HORTON

JSC Producers has appealed from a decision of the Wyoming State Office, Bureau of Land Management (BLM), dated January 21, 1985, declaring appellant's oil and gas lease, W-42623-A, to have expired under its own terms.

Effective August 1, 1983, BLM approved a partial assignment of the record title interest in oil and gas lease W-42623 from Grace Petroleum Corporation to appellant. Lease W-42623 had originally been issued for a 10-year term with an effective date of January 1, 1974. The assignment resulted in the creation of lease W-42623-A, covering 160 acres of land situated in the NE 1/4 sec. 22, T. 46 N., R. 76 W., sixth principal meridian, Campbell County, Wyoming.

On August 18, 1983, BLM approved appellant's application for a permit to drill the Federal AU-1 well to a proposed depth of 11,700 feet on lease W-42623-A. This well is situated in the NE 1/4 NE 1/4 sec. 22, T. 46 N., R. 76 W., sixth principal meridian, Campbell County, Wyoming, within the North Prong field. Appellant had earlier reported that the well had been plugged and abandoned on July 12, 1977. In a geologic report, dated August 16, 1983, a BLM geologist had reported possible oil and/or gas resources in several formations, with the primary objective being the Muddy formation at a depth of 11,640 feet.

The record indicates that the well was re-entered on August 26, 1983, and drilling and development activity continued until October 25, 1983, when, according to a progress report received by BLM November 1, 1983, "all operations [were] suspended until further notice." It appears that during that time, both the Muddy and Turner formations had been perforated with total production of approximately 18 barrels of oil. The Muddy formation had also been stress-fractured.

By memorandum dated December 12, 1984, the Area Manager, Buffalo Resource Area, reported to the State Director that "[o]ur records do not reflect any drilling activity on [lease W-42623-A] over the end of its primary term date of 12-31-83." In its January 1985 decision, BLM declared that appellant's lease had expired by its own terms effective December 31, 1983:

We have been advised by our field office that no drilling operations were in progress over the end of the primary term. Nor are we aware of any other provision of the regulations that would entitle this lease to an extension.

By letters dated December 21, 1984, and February 12, 1985, BLM ordered appellant to plug and abandon the Federal AU-1 well.

In its statement of reasons for appeal, appellant contends that its lease should have received a 2-year extension "from the date it was segregated from the main lease" and that, in any case, it was capable of producing in paying quantities at the end of its primary term. In a statement received May 15, 1985, appellant explained that it had suspended well operations because "continual plugging of the tubing due to mud filtrate and debris, combined with unforeseen problems, depleted our working capital," but that otherwise the well was capable of commercial production as indicated by the pressure of the reservoir at the time oil was produced (5700 PSI) and current wellhead pressure (950 PSI). ^{1/} Appellant has provided a number of well logs dating from 1977, as well as a September 4, 1983, well log, and an April 1, 1985, letter from O. R. Laurel, a petroleum engineer. Mr. Laurel

^{1/} The Board has also received a letter from Jim's Water Service, Inc. (JWS), to whom appellant has assigned lease W-42623-A by agreement dated May 20, 1985. The assignment does not appear to be approved by BLM. Absent such approval, appellant remains the record title holder. 30 U.S.C. § 187a (1982); 43 CFR 3106.7-2; Grace Petroleum Corp., 62 IBLA 180 (1982). Nevertheless, JWS supports appellant's contention that the Federal AU-1 well is capable of producing in paying quantities:

"It is our strong feeling that the well is capable of commercial production with a minimal amount of cleanup and the possible installation of a plunger lift device as a lifting mechanism. By actual field inspection we have determined, to our satisfaction, that there is sufficient gas volume to drive such mechanism and lift oil from the formation.

"We are willing to expend the necessary funds to put the well into operation and have the expertise to do so. There is approximately 600 pounds pressure on the tubing string at present and oil is in the string virtually to the surface. This is seldom the case in an unproductive well."

reports that at the time of production from the Muddy formation, the formation had "flowed and swabbed 60 bbls. oil with high gas oil ratio" and that appellant simply had insufficient funds at that time to "fracture stimulate" the formation in order "to sustain continued production." In an October 1984 visit to the wellsite, Mr. Laurel noted a wellhead pressure of 950 PSI: "I opened the choke and flowed oil and gas to the pit for 2-3 minutes. No apparent drop in wellhead pressure was observed."

[1] Section 30a of the Mineral Leasing Act, as amended, 30 U.S.C. § 187a (1982), provides that a "partial assignment" of an oil and gas lease

shall segregate the assigned and retained portions thereof * * * and such segregated leases shall continue in full force and effect for the primary term of the original lease, but for not less than two years after the date of discovery of oil or gas in paying quantities upon any other segregated portion of the lands originally subject to such lease.

Thus, due to the partial assignment of lease W-42623 to appellant, the assigned portion of the lease became segregated from the retained portion of the lease on the effective date of the assignment, *i.e.*, August 1, 1983. See Robert N. & Mona Enfield, 4 IBLA 317 (1972). Both the assigned and retained portions of the lease are deemed to be "separate leases." Franco Western Oil Co., 65 I.D. 316, 319 (1958); 43 CFR 3106.7-5.

The statute also establishes that the segregated leases shall continue in effect for the "primary term of the original lease." 30 U.S.C. § 187a (1982). Thus, the assigned portion of lease W-42623 held by appellant would continue in effect for the 10-year primary term of that lease, *i.e.*, until December 31, 1983. See 30 U.S.C. § 226(e) (1982). However, that term could be extended under the statute if oil or gas in paying quantities is discovered on any portion of the original lease within 2 years prior to the end of the primary term of that lease. Under such circumstances, appellant's lease would then continue in effect for 2 years "after the date of discovery of oil or gas in paying quantities." 30 U.S.C. § 187a (1982); see 43 CFR 3107.5-1; Partial Assignment of Oil and Gas Leases, Solicitor's Opinion, 62 I.D. 216, 218 (1955).

Appellant argues that segregation of its lease by virtue of the partial assignment itself entitles the assigned lease to a "two year extension from the date it was segregated." There is no statutory provision, however, that accords a segregated lease a 2-year extension in the case of a partial assignment during the primary term of the original lease merely because of the segregation. The triggering mechanism in the above-quoted statute for the 2-year continuation of the lease is not the segregation of the lease alone but the "discovery of oil or gas in paying quantities." Compare 30 U.S.C. §§ 187a (lease "held beyond its primary term by production") and 226(j) (1982) (non-unitized portion of lease and lease eliminated from unit continued for not less than 2 years and then held by production); see Anadarko Production Co., 92 IBLA 212, 93 I.D. 246 (1986).

We turn to the question of whether oil or gas had been discovered in paying quantities on any portion of original lease W-42623 prior to the end of its primary term, which would have entitled appellant's lease to a

2-year continuation. Discovery of oil or gas in paying quantities is distinguished from completion of a well physically capable of producing oil or gas in paying quantities. Joseph I. O'Neill, Jr., 1 IBLA 56 (1970). The statutory requirement of discovery merely means to find oil or gas "in sufficient quantities for profitable production." Id. at 61. Based on progress reports of the operations on the Federal AU-1 well, between August 26, 1983, and October 25, 1983, it is not apparent that appellant had discovered oil or gas in paying quantities. Despite considerable effort to extract oil or gas from two promising formations, the resulting oil production was spotty and meager. It is uncertain whether additional measures would be any more productive of oil or gas. In a January 30, 1985, memorandum to the files, a BLM employee reports a conversation with Frank Shaw, a petroleum engineer, who, after reviewing the progress reports, concluded that the well is not "capable of producing paying quantities of oil." From the evidence of record, we conclude that appellant had not discovered oil or gas in paying quantities in the Federal AU-1 well prior to expiration of the primary term of lease W-42623. 2/

With respect to the discovery of oil or gas in paying quantities on "any other segregated portion" of lease W-42623 (30 U.S.C. § 187a (1982)), the January 1985 BLM decision states that there had been a discovery "on W-42623 prior to the effective date of the assignment creating W-42623-A." (Emphasis in original.) BLM concluded that because discovery preceded the assignment creating W-42623-A, appellant was not entitled to an extension under 30 U.S.C. § 187a (1982). Thus, BLM would limit the statutory extension for leases segregated by partial assignment only to circumstances where oil or gas is discovered after the effective date of the assignment. No legal authority for this interpretation was included in the BLM decision, though this same position is advocated in BLM's manual of operations. See BLM Manual Handbook 3107-1 at 11. 3/

Nothing in 30 U.S.C. § 187a (1982) or 43 CFR 3107.5-1 (which implements the statutory provision but does not deviate from the statutory language) expressly states or necessarily implies that the limitation stated by BLM is justified. Indeed, the limitation has the effect of excluding a whole class of leases segregated by partial assignment during the primary term of the original lease from the benefit of statutory extension merely because the assignment occurred after the discovery. We cannot say that the statute supports this limitation. BLM may be relying on the statement

2/ We must also conclude that the well was not demonstrated to be physically capable of producing oil or gas in paying quantities, which might entitle appellant to avoid expiration of its assigned lease under 30 U.S.C. § 226(f) (1982) and 43 CFR 3107.2-3. Cf. Max Barash, 6 IBLA 179 (1972). At best, appellant has established a "potential capability" which is insufficient. American Resources Management Corp., 40 IBLA 195, 202 (1979); cf. Coronado Oil Co., 42 IBLA 235 (1979).

3/ BLM Manual provisions are not endowed with the force of law and are therefore not binding on the Board. Pamela S. Crocker-Davis, 94 IBLA 328, 332 (1986).

in 30 U.S.C. § 187a (1982) that the 2-year period runs from the date of discovery "upon any other segregated portion of the lands originally subject to [the original] lease." However, we do not read this statement to mean that the discovery must be made at the time the "other" portions of the original lease are segregated. Rather, the reference to "segregated" appears intended to emphasize that the qualifying discovery may be made on any other portion of the original lease, even though it may be segregated.

The Board holds that the better interpretation and that which comports with Congressional intent in enacting statutory extensions to afford oil and gas lessees additional opportunities to develop their leases is that expressed in Solicitor's Opinion, M-36472 (Nov. 20, 1957). In that opinion, the Associate Solicitor, construing the relevant language in 30 U.S.C. § 187a (1982), stated that "the extension after discovery provision applies to assignments made before, as well as after discovery." 4/ Id. at 3. The only limitation in the case of leases in their primary term would be that the discovery must be made within 2 years prior to the end of the primary term of the original lease. 5/ Given that fact, a lease subsequently created by partial assignment would benefit from the statutory extension, and could be extended up to almost 2 years. This, of course, would give the assignee an opportunity to develop the assigned lease, as well as encourage the partial assignment of leases, particularly undeveloped portions, to those who might independently develop them.

In this case, had a lease not been created by partial assignment, the leased lands in W-42623 would possibly have benefited from discovery and subsequent production in paying quantities as a part of the original lease under 30 U.S.C. § 226(e) (1982): "Each * * * lease shall continue so long after its primary term as oil or gas is produced in paying quantities." We see no reason to penalize the owner of such an assigned lease merely because the assignment occurred after discovery by denying the assignee the benefit of the statutory provision arising from discovery. 6/

4/ In Extension of Segregated Lease, Solicitor's Opinion, 64 I.D. 309, 310 (1957), it is said generally that: "The provision for lease continuance for 2 years is intended to guarantee the assignee * * * a minimum period of 2 years in which to develop the lease." See also Solicitor's Opinion, M-36432 (May 13, 1957) at 10. The case of Duncan Miller, 70 I.D. 1 (1963), appeal dismissed, Miller v. Udall, Civ. No. 931-63 (D.D.C. Apr. 21, 1966), provides examples of segregated leases afforded 2-year continuances from the date of discovery where the partial assignments predated the discovery.

5/ We note that in Solicitor's Opinion, M-36432 (May 13, 1957), at 7, the Deputy Solicitor stated that extensions under the relevant language of 30 U.S.C. § 187a (1982) "must have as their basis a partial assignment * * * made during the pre-authorized primary term." No mention is made that discovery must occur after the assignment.

6/ Some of these same arguments were made in the case of C. W. Grier & George Etz, 58 I.D. 712 (1944), a case which predates passage of section 7 of the Act of Aug. 8, 1946, ch. 916, 60 Stat. 955 (1946), which amended the Mineral Leasing Act in relevant part. That case, decided May 12, 1944, involved discovery

Accordingly, we set aside the January 1985 BLM decision to the extent it held that lease W-42623-A was not entitled to an extension under 30 U.S.C. § 187a (1982) and 43 CFR 3107.5-1 by virtue of the "discovery" of oil or gas in paying quantities on the original lease, W-42623. Cf. Conoco, Inc., 90 IBLA 388 (1986). The decision does not state when that discovery occurred. Therefore, we are unable to determine the expiration of appellant's 2-year continuation and whether this resulted in any extension of the assigned lease. We only know that the discovery occurred sometime prior to August 1, 1983, i.e., the "effective date of the assignment creating W-42623-A." We therefore remand this case to BLM to determine the expiration of appellant's 2-year continuation under 30 U.S.C. § 187a (1982), and whether appellant was entitled to any further extension of its lease.

Pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision appealed from is set aside and the case is remanded to BLM for further action consistent herewith.

Wm. Philip Horton
Chief Administrative Judge

We concur:

Franklin D. Arness
Administrative Judge

John H. Kelly
Administrative Judge

fn. 6 (continued)

of oil and gas in commercial quantities on the assigned portion of an oil and gas lease, prior to approval of the partial assignment. The Assistant Secretary concluded that, because the assignment effected a segregation of the assigned and retained portions of the lease, after approval of the assignment the retained portion could not be considered held by subsequent production on the assigned portion of the lease, but would terminate at the end of its primary term. At that time, there simply was no statutory means to afford the retained (or, for that matter, the assigned) portion of a lease the benefit of any extended term by reason of discovery or production of oil or gas on the assigned (or retained) lands during the primary term of the original lease. The statutory amendment appears designed to effect a remedy in such cases, including those cases where discovery predates the assignment.

